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**SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.**

**CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2007**

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Under provisions of state law, this report is a public document. A copy of the report has been submitted to the entity and other appropriate public officials. The report is available for public inspection at the Baton Rouge office of the Legislative Auditor and, where appropriate, at the office of the parish clerk of court.

Release Date 8/6/08

**P&N** Postlethwaite  
& Netterville

A Professional Accounting Corporation

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**SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.**

**CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2007**

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### INDEPENDENT AUDITORS' REPORT

The Board of Trustees  
Southwest Louisiana Health Care System, Inc.

We have audited the accompanying consolidated balance sheets of Southwest Louisiana Health Care System, Inc. and its affiliates (the System) as of December 31, 2007 and 2006, and the related consolidated statements of changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Southwest Louisiana Health Care System, Inc. and its affiliates as of December 31, 2007 and 2006, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 26, 2008, on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

*Postlethwaite & Netterville*

Baton Rouge, Louisiana  
April 17, 2008

**SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.**

**CONSOLIDATED BALANCE SHEETS**  
**DECEMBER 31, 2007 AND 2006**

**ASSETS**

<i>(in thousands)</i>	<u>2007</u>	<u>2006</u>
<b><u>CURRENT ASSETS</u></b>		
Cash and cash equivalents	\$ 12,611	\$ 5,784
Investment in Louisiana Hospital Investment Pool	5,624	5,327
Patient accounts receivable, net of allowances for contractual adjustments and doubtful accounts of approximately \$48,496 and \$42,005 at December 31, 2007 and 2006, respectively	26,387	27,717
Assets limited as to use - current portion	1,893	2,453
Inventory	2,412	2,300
Other current assets	2,441	3,720
Total current assets	<u>51,368</u>	<u>47,301</u>
<b><u>ASSETS LIMITED AS TO USE</u></b>		
Held by trustee in accordance with bond indentures	11,425	11,618
Internally designated for malpractice claims	1,308	1,719
Total assets whose use is limited	12,733	13,337
Less: amounts required to meet current liabilities	(1,893)	(2,453)
Noncurrent assets limited as to use	<u>10,840</u>	<u>10,884</u>
<b><u>PROPERTY AND EQUIPMENT, net</u></b>	<u>88,219</u>	<u>94,199</u>
Total property and equipment, net	<u>88,219</u>	<u>94,199</u>
<b><u>OTHER ASSETS</u></b>		
Deferred financing costs	2,889	2,943
Other	434	376
Total other assets	<u>3,323</u>	<u>3,319</u>
<b>TOTAL ASSETS</b>	<u><u>\$ 153,750</u></u>	<u><u>\$ 155,703</u></u>

The accompanying notes are an integral part of these statements.

# LIABILITIES AND NET ASSETS

(in thousands)

	<u>2007</u>	<u>2006</u>
<b><u>CURRENT LIABILITIES</u></b>		
Current portion of long-term debt	\$ 3,124	\$ 3,163
Accrued interest payable	675	533
Accounts payable	5,885	7,026
Accrued compensation and benefits	6,351	6,211
Estimated third-party payor settlements	1,935	1,743
Other accrued expenses	4,297	5,077
Credit balances in patient accounts receivable	251	694
Total current liabilities	<u>22,518</u>	<u>24,447</u>
<b><u>LONG-TERM DEBT</u>, net of current portion</b>	<u>104,958</u>	<u>96,941</u>
Total long-term debt, net of current portion	<u>104,958</u>	<u>96,941</u>
Total liabilities	<u>127,476</u>	<u>121,388</u>
<b><u>MINORITY INTEREST</u></b>	<u>(61)</u>	<u>110</u>
<b><u>UNRESTRICTED NET ASSETS</u></b>	<u>26,335</u>	<u>34,205</u>
Total net assets	<u>26,335</u>	<u>34,205</u>
 <b>TOTAL LIABILITIES AND NET ASSETS</b>	 <b><u>\$ 153,750</u></b>	 <b><u>\$ 155,703</u></b>

**SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.**

**CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS**  
**YEARS ENDED DECEMBER 31, 2007 AND 2006**

(in thousands)

	<u>2007</u>	<u>2006</u>
<b><u>OPERATING REVENUES</u></b>		
Net patient service revenue	\$ 189,370	\$ 169,737
Other operating revenues	<u>12,762</u>	<u>19,954</u>
Total operating revenues	<u>202,132</u>	<u>189,691</u>
<b><u>OPERATING EXPENSES</u></b>		
Salaries and wages	65,438	62,325
Employee benefits	16,832	15,997
Contract labor	3,808	6,804
Supplies	39,967	36,363
Professional fees	3,410	3,021
Service contracts	2,576	2,171
Purchased services	15,324	16,075
Management fees	4,144	4,022
Depreciation and amortization	11,005	10,537
Interest expense	6,917	7,206
Provision for doubtful accounts	18,455	15,610
Insurance	6,520	4,262
Other	<u>9,171</u>	<u>10,078</u>
Total operating expenses	<u>203,567</u>	<u>194,471</u>
<b>INCOME (LOSS) FROM OPERATIONS</b>	(1,435)	(4,780)
<b><u>NONOPERATING REVENUES (EXPENSES)</u></b>		
Contributions	128	186
Earnings from affiliate	-	(28)
Other revenues (expenses) - net	1,792	1,200
Loss on early distinguishment of debt	<u>(8,283)</u>	<u>-</u>
	<u>(6,363)</u>	<u>1,358</u>
<b>REVENUES OVER (UNDER) EXPENSES</b>	(7,798)	(3,422)
Change in fair value of investments	82	(54)
Minority interest	<u>(154)</u>	<u>(173)</u>
<b>CHANGE IN NET ASSETS</b>	(7,870)	(3,649)
Net assets - beginning of year	<u>34,205</u>	<u>37,854</u>
<b>NET ASSETS - END OF YEAR</b>	<u><u>\$ 26,335</u></u>	<u><u>\$ 34,205</u></u>

The accompanying notes are an integral part of these statements.

**SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**YEARS ENDED DECEMBER 31, 2007 AND 2006**

<i>(in thousands)</i>	<u>2007</u>	<u>2006</u>
<b><u>CASH FLOWS FROM OPERATING ACTIVITIES</u></b>		
Change in net assets	\$ (7,870)	\$ (3,649)
Adjustments to reconcile the changes in net assets to net cash provided by operating activities:		
Depreciation and amortization	11,005	10,537
Net unrealized losses (gains) on investments	(82)	54
Provision for doubtful accounts	18,455	15,610
Noncash portion of minority interest	154	-
Noncash portion of loss on defeasance of debt	1,858	-
Changes in operating assets and liabilities:		
Patient accounts receivable	(17,376)	(20,019)
Inventories and other current assets	1,167	(445)
Other assets	(58)	590
Accounts payable and accrued expenses	(1,639)	348
Net cash provided by operating activities	<u>5,614</u>	<u>3,026</u>
<b><u>CASH FLOWS FROM INVESTING ACTIVITIES</u></b>		
Acquisitions of property and equipment	(4,431)	(16,933)
Sale (purchase) of investments	(297)	4,889
Net cash invested in assets whose use is limited	686	(1,043)
Net cash used in investing activities	<u>(4,042)</u>	<u>(13,087)</u>
<b><u>CASH FLOWS FROM FINANCING ACTIVITIES</u></b>		
Principal payments on revenue bonds and notes	(62,228)	(2,149)
Proceeds from leases	-	7,990
Cash paid to minority shareholders	(325)	-
Deferred financing costs paid	(1,967)	-
Proceeds from issuance of revenue bonds	69,775	-
Net cash provided by financing activities	<u>5,255</u>	<u>5,841</u>
<b><u>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</u></b>	6,827	(4,220)
Cash and cash equivalents at beginning of year	<u>5,784</u>	<u>10,004</u>
Cash and cash equivalents at end of year	<u>\$ 12,611</u>	<u>\$ 5,784</u>
<b><u>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</u></b>		
Cash paid during the year for interest	<u>\$ 6,775</u>	<u>\$ 7,214</u>

The accompanying notes are an integral part of these statements.



## SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 1. Summary of significant accounting policies

Southwest Louisiana Health Care System, Inc. (the System) is organized as a Louisiana not-for-profit corporation for the purpose of conducting charitable, scientific, and educational activities. The System is legally designated as the "sole member" of its affiliates and, through the actions of its Board of Trustees, has the power to change or elect the Board of Trustees, approve certain corporate actions, and amend the articles of incorporation of its affiliates, thereby functioning in the capacity of sole shareholder.

The accounting and reporting policies of the System conform to accounting principles generally accepted in the United States of America and the prevailing practices within the healthcare industry. The significant accounting policies used by the System in preparing and presenting its financial statements are summarized as follows:

#### Principles of consolidation

The consolidated financial statements include the Southwest Louisiana Hospital Association, d/b/a Lake Charles Memorial Hospital (the Hospital), the major operating unit in the System. The Hospital provides a wide range of inpatient and outpatient services through a 362-bed acute care facility, a 29 bed long term acute facility and satellite locations. Also included in the consolidated financial statements are the Lake Charles Memorial Heart and Vascular Center, a tax paying Louisiana corporation operating cardiology clinics, which was originally incorporated as a not-for-profit organization; SWLHS Oncology, Inc., a tax paying Louisiana corporation operating oncology clinics, which was originally incorporated as a not-for-profit organization; and SWLHS, Inc., a wholly-owned corporation formed for the purpose of entering into for-profit healthcare ventures. Through these entities, the System provides integrated healthcare services in southwest Louisiana and southeast Texas.

The System is also a 51% owner in an MRI joint venture, which began operations in January of 2006. The joint venture has a capital lease for equipment in the original amount of approximately \$2,100,000 (See Note 6) and is consolidated in the accompanying financial statements due to the System's ownership percentage exceeding 50%.

The accompanying consolidated financial statements include the accounts of the System and its controlled affiliates. All significant intercompany accounts and transactions have been eliminated in consolidation.

#### Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

#### Cash and cash equivalents

Cash and cash equivalents includes all checking accounts and certain investments in highly liquid debt instruments which had maturities of three months or less at the time of purchase.

**SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

1. Summary of significant accounting policies (continued)

Short term investments

Short term investments include all savings accounts, money market funds, and Louisiana Hospital Investment Pool investments.

Investments and investment income

The System follows the provisions of Statement of Financial Accounting Standards (SFAS) No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*. Under the provisions of SFAS No. 124, investments in equity securities with readily determinable fair values and all investments in debt securities are measured at their fair value in the balance sheets based on quoted market prices.

Investment income or loss (including realized gains and losses on investments, interest, and dividends) is recorded as an increase in unrestricted net assets, unless the use is restricted by the donor or law. Investment income on proceeds of borrowings that are held by a trustee, to the extent not capitalized, are reported as other operating revenues.

Donated investments are recorded at their market value at the date of receipt, which is then treated as cost. Realized gains and losses on dispositions are based on the net proceeds and the adjusted cost bases of the securities sold, using the specific identification method. These realized gains and losses flow through the System's yearly activities.

Assets limited as to use

Assets limited as to use primarily include assets held by trustees under indenture agreements and designated assets set aside by the Board of Trustees, over which the Board retains control and may at its discretion subsequently use for other purposes. Amounts required to meet current liabilities of the System have been reclassified in the consolidated balance sheets.

Patient accounts receivable

The System provides credit in the normal course of operations to patients located primarily in southwestern Louisiana and southeastern Texas and to third party payors conducting operations in these areas.

The System maintains allowances for contractual adjustments, doubtful accounts, and charity care based on management's assessment of collectibility, current economic conditions, and prior experience. The System determines if patient accounts receivable are past-due based on the discharge date; however, the System does not charge interest on past-due accounts. The System charges off patient accounts receivable if management considers the collection of the outstanding balances to be doubtful.

**SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

1. Summary of significant accounting policies (continued)

Inventories

Inventories consist primarily of medical supplies, general supplies, and drugs and are stated at the lower of cost (using the first-in, first-out method) or market.

Property and equipment

Property and equipment are stated at historical cost. Donated property is recorded at its estimated fair value on the date of receipt, which is then treated as cost. Additions, renewals, and betterments that extend the lives of assets are capitalized. Maintenance and repair expenditures are expensed as incurred.

Depreciation has been provided using the straight-line method over the estimated useful lives of the related assets, which range from 2 to 40 years.

When assets are retired or otherwise disposed of, the costs and related accumulated depreciation are removed from the accounts, and any resulting gains and losses are recognized in the System's yearly operations.

Other assets

Other assets consist primarily of investments in affiliated entities, including Lake Charles Pharmaceutical and Medical Supply Company, LLC and Louisiana Pet Imaging of Lake Charles, LLC. The System accounts for investments in affiliated entities of which it owns more than 20% but no more than 50%, using the equity method.

Costs of borrowing

Interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. Financing costs are amortized on a straight-line basis over the period that the related obligation is outstanding.

Temporarily and permanently restricted net assets

Temporarily restricted net assets are those whose use by the System has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the System in perpetuity. The System did not have any temporarily restricted or permanently restricted net assets at December 31, 2007 or 2006.

**SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

1. Summary of significant accounting policies (continued)

Income (loss) from operations

The statements of changes in net assets include the line item entitled income (loss) from operations. Operating revenues include, but are not limited to, patient revenues, investment income from unrestricted assets, cafeteria revenues, and insurance proceeds. Changes in unrestricted net assets which are excluded from income (loss) from operations include contributions, rental revenues, and other non-operating activities.

Net patient service revenue

The System has agreements with third-party payors that provide for payments to the System at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period that the related services are rendered and adjusted in future periods as final settlements are determined or as years are no longer subject to examination. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. Consequently, there is at least a reasonable possibility that recorded estimates could change by a material amount.

Charity care

The System provides care to patients who meet certain criteria established under its charity care policy without expected reimbursements or at reimbursement rates substantially lower than its prevailing rates. The related amounts are not reported as net revenues because the System does not pursue collection of amounts determined to qualify as charity care.

Donor-restricted gifts

Unconditional promises to give cash and other assets to the System are reported at their fair values at the date the promises are received. Conditional promises to give and indications of intentions to give are reported at their fair values at the date the gifts are received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statements of changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying financial statements.

**SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

1. Summary of significant accounting policies (continued)

Professional liability claims

The provision for estimated malpractice claims includes estimates of the ultimate cost for both reported claims and claims incurred but not reported. The System has not experienced material losses from professional liability claims in the past.

Income Taxes

The Hospital and certain other affiliates are not-for-profit organizations as described in Section 501(c)(3) of the Internal Revenue Code and are exempt from federal and state income taxes on related income pursuant to Section 501(a) of the Internal Revenue Code. Certain other affiliates are either for-profit entities or not-for-profit tax paying entities. Federal income tax liabilities generated by the System's taxable activities, if any, is insignificant. Accordingly, no provision for income taxes on related income has been included in the consolidated financial statements.

Reclassifications

Certain reclassifications have been made to the 2006 financial statements to conform with the 2007 presentation.

## SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### 2. Current operating environment

The Hospital continued to recover from the effects of Hurricane Rita during fiscal 2007. The Hospital had a net loss from operations of \$1,435,000 for the year ended December 31, 2007 compared to a net loss of \$4,780,000 for the year ended December 31, 2006. Included in the fiscal 2007 net loss from operations are \$4,664,000 on uncompensated care payments received from the state of Louisiana and \$3,448,000 of insurance proceeds, reflected in other operating revenue in the accompanying financial statements, as a result of a final settlement of Hurricane Rita insurance claims as well as \$2,661,000 of expenses related to the hurricane. The total net loss of the Hospital for fiscal 2007 was \$7,870,000 which included a loss on early extinguishment of debt of \$8,283,000.

As of the end of 2007, the System had negotiated a settlement with its insurer regarding the business interruption and property damages claim in the wake of Hurricane Rita. In summary, as a result of Hurricane Rita, the System sustained an agreed upon cumulative loss of \$11,316,000 in property damages and \$8,804,000 with respect to business income and extra expenses. In finalizing the claim and taking the System's \$500,000 wind deductible into account, approximately \$19,620,000 was paid to the System since 2005 for property damages and business interruption losses combined.

During fiscal 2007, the System's new President and CEO continued to establish his senior leadership team, expanded the scope of the short term business plan; initiated the development of a longer range business plan and the implementation of a physician recruitment plan; and continued reviews in multiple areas of the System designed to enhance financial and operational improvement, as well as cost containment, customer service excellence and market share growth.

#### 3. Net patient service revenue

The System has agreements with governmental and other third-party payors that provide for payments to the System at amounts different from its established rates. Contractual adjustments under third-party reimbursement programs represent the differences between the System's billings at established rates for services and amounts reimbursed by third-party payors. A summary of the basis of reimbursement with third-party payors follows:

- *Medicare* - inpatient acute and sub acute care services, skilled nursing services, outpatient services, and home health services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Certain costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. The System is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicare fiscal intermediary.

**SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

3. Net patient service revenue (continued)

- *Medicaid* - inpatient services rendered to Medicaid program beneficiaries are reimbursed at a prospectively determined rate-per-diem. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Certain extraordinary inpatient costs for children under the age of one are eligible for additional reimbursement. Outpatient services are reimbursed at a prospectively determined fee schedule. For the small number of outpatient services where no fee schedule has been developed, outpatient services are paid based on a cost reimbursement methodology. The System is paid for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicaid fiscal intermediary.
- *Commercial and HMO* - the System has entered into agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. Payment methodologies under these agreements include prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Amounts receivable or payable under reimbursement agreements with the Medicare and Medicaid programs are subject to examination and retroactive adjustments. Provisions for estimated retroactive adjustments under such programs are provided for in the period the related services are rendered and adjusted in future periods as final settlements are determined. The retroactive settlements payable were approximately \$1,935,000 and \$1,743,000 at December 31, 2007 and 2006, respectively. The 2007 and 2006 net patient service revenue decreased approximately \$825,000 and \$55,000 due to prior-year retroactive adjustments in excess of amounts previously estimated and the removal of allowances previously estimated that are no longer necessary as a result of final settlements and years that are no longer subject to audits, reviews, and investigations. As of December 31, 2007, final settlements had been made by the Medicaid program for all years ended through December 31, 2003, and final settlements had been made by the Medicare program for all years ended through December 31, 2004. Since the laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

Presented below is a summary of net patient service revenue for the years ended December 31, 2007 and 2006 (in thousands):

	<u>2007</u>	<u>2006</u>
Gross patient service revenue	\$ 578,655	\$ 514,871
Less: contractual adjustments and other deductions	( 389,285)	( 345,134)
Net patient service revenue	<u>\$ 189,370</u>	<u>\$ 169,737</u>

**SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

4. Investments/Assets limited as to use

The composition of assets limited as to use at December 31, 2007 and 2006, is set forth in the following table. Investments are stated at fair value (in thousands).

	<u>2007</u>	<u>2006</u>
Assets held by the trustee in accordance with bond indenture agreements:		
Cash and cash equivalents	\$ 4,639	\$ 7,192
U. S. Government agencies	118	152
Investment agreements	<u>6,668</u>	<u>4,274</u>
	11,425	11,618
Less: amount classified as current	<u>( 1,893)</u>	<u>( 2,453)</u>
	<u>\$ 9,532</u>	<u>\$ 9,165</u>
Assets internally designated by the Board of Trustees for professional liability claims and other matters:		
Cash and cash equivalents	\$ 481	\$ 29
U.S. Government agencies	<u>827</u>	<u>1,690</u>
	<u>\$ 1,308</u>	<u>\$ 1,719</u>
Total non-current assets limited as to use	<u>\$ 10,840</u>	<u>\$ 10,884</u>

Use of the bond trust funds is generally limited to payment of debt service, maintenance of reserve funds, and security for bondholders. Use of the professional liability fund is limited by the Board of Trustees for the payment of professional liability claims and related expenses.

Other short-term investments, which represent the Louisiana Hospital Investment Pool, totalled approximately \$5,624,000 and \$5,327,000 at December 31, 2007 and 2006, and are comprised of U.S. Government agencies, mutual funds, and equity investments.

The System recognized investment revenues of approximately \$1,324,000 and \$1,427,000 during the years ended December 31, 2007 and 2006, respectively. These amounts are classified as other operating revenues in the statements of changes in net assets.



**SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

5. Property and equipment

Property and equipment at December 31, 2007 and 2006 consisted of the following (in thousands):

	<u>2007</u>	<u>2006</u>
Land and land improvements	\$ 13,660	\$ 13,728
Buildings and improvements	130,368	131,778
Equipment, furniture, and fixtures	<u>105,026</u>	<u>119,120</u>
	249,054	264,626
Less: accumulated depreciation	( <u>161,247</u> )	( <u>172,342</u> )
	87,807	92,284
Construction-in-progress	<u>412</u>	<u>1,915</u>
Property and equipment, net	<u>\$ 88,219</u>	<u>\$ 94,199</u>

Depreciation expense amounted to approximately \$10,840,000 and \$10,390,000 during the years ended December 31, 2007 and 2006, respectively.

**SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

6. Long-term debt

A summary of long-term debt at December 31, 2007 and 2006 is as follows (in thousands):

	<u>2007</u>	<u>2006</u>
Hospital Revenue Bonds (Series 1992); term bonds due at various dates through December 1, 2018, at rates ranging from 5.1% to 7.5%.	\$ 17,590	\$ 36,000
Hospital Revenue Bonds (Series 1993); serial bonds due annually on November 30 <sup>th</sup> through November 30, 2018, at variable rates.	10,800	11,340
Hospital Revenue Bonds (Series 2000); term bonds subject to sinking fund requirements	-	41,800
Hospital Revenue Bonds (Series 2007); term bonds due annually on December 1 <sup>st</sup> through December 1, 2034, at rates ranging from 6.25% - 6.375%	69,550	-
Lease due in monthly installments through October of 2013 at 4.09% (IMRT).	3,557	4,027
Lease due in monthly installments through August of 2011 at 4.49% (CT SCAN).	1,447	1,714
Lease due in monthly installments through February of 2011 at 6.69% (AMRI).	1,492	1,901
Term loan due in monthly installments through October of 2010 at 7.00% (McKesson)	677	-
Term loan due in monthly installments through April of 2022, at a variable rate (7.94% and 10.00% at December 31, 2007 and 2006, respectively); secured by real estate.	<u>2,910</u>	<u>3,037</u>
	108,023	99,819
Less: current portion of long-term debt	( 3,124)	( 3,163)
Add: unamortized bond discounts and premiums, net	59	285
Long-term debt, net	<u>\$ 104,958</u>	<u>\$ 96,941</u>

Under the terms of the revenue bond indentures, the restricted group was originally comprised of Southwest Louisiana Health Care System, Inc. and the Hospital. At the end of 2004, the System designated several new members to the restricted group. The restricted group currently consists of the System, The Hospital, SWLHS, Inc. and Lake Charles Medical Services, Inc.

**SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

6. Long-term debt (continued)

The restricted group is required to maintain certain deposits with the Trustee, and such deposits are included with assets limited as to use. The revenue bond indentures also place limits on the incurrence of additional borrowings, place limits on the amount of assets that can be disposed of outside the normal course of business, and require the restricted group to satisfy measures of financial performance as long as the bonds are outstanding.

As related to the net losses of \$6,283,000 and \$10,115,000 in 2002 and 2003 respectively, the previously reported failure of the System to meet certain bond indenture covenants and the required engagement of management consultants and other matters, the System filed an action during 2006 in Federal Court against multiple entities and individuals for damages and rescission of contracts and an acknowledgment that the Hospital and the System was not in default. One defendant to that litigation settled prior to the end of 2006 and was dismissed with reservation of rights against all other defendants. The terms of that settlement agreement was subject to non-disclosure; however the settlement amount, if any, was included in the accompanying 2006 financial statements. During 2007, two additional defendants were dismissed with reservation of rights against the remaining parties to the action as a result of a negotiated settlement agreement. The terms of that agreement are also subject to non-disclosure requirements; however the settlement amount, if any, was included in the accompanying 2007 financial statements.

The litigation is ongoing as of the issuance of these financial statements, and Management is proceeding vigorously to litigate its rights in relationship to the litigation. System counsel feels that it is too early to predict the outcome of the litigation. Insurance coverages, if any as related to this matter, are unknown at this time.

The long-term debt and capital lease obligations are scheduled to mature as follows:

<u>Year ending December 31st,</u>	<u>Bonds &amp; Notes Payable</u>	<u>Capital Leases</u>	<u>Total</u>
2008	\$ 2,480	\$ 1,614	\$ 4,094
2009	2,635	1,834	4,469
2010	2,795	1,777	4,572
2011	2,975	1,298	4,273
2012	3,170	626	3,796
Thereafter	<u>86,795</u>	<u>921</u>	<u>87,716</u>
	100,850	8,070	108,920
Less: interest	-	( 897)	( 897)
Add: unamortized bond discount and premiums, net	<u>59</u>	<u>-</u>	<u>59</u>
Total long-term debt	<u>\$ 100,909</u>	<u>\$ 7,173</u>	<u>\$ 108,082</u>

**SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

6. Long-term debt (continued)

Hospital Revenue Bonds (Series 1978):

The 1978 Bond Issue has been defeased and, therefore, is no longer included in the consolidated balance sheets. The unpaid principal balance as of December 31, 2007, was approximately \$990,000.

Hospital Revenue Bonds (Series 1992):

The Series 1992 tax-exempt bonds were issued by the Memorial Hospital Service District of the Parish of Calcasieu, Louisiana on behalf of the System. The payments to the bondholders are funded and guaranteed by the System under loan agreements with the trustees of the respective bond issues.

The Series 1992 bonds were issued to establish an irrevocable escrow to advance refund certain previous bonds, to provide funds for the System's additions and improvements, and to retire existing equipment notes. Interest on the term bonds maturing on December 1, 2022, was accreted to its principal amount of \$11,040,000 at December 1, 2006. Semi-annual interest payments began after December 31, 2006. Interest of approximately \$721,170 was accreted on these bonds during the year ended December 31, 2006. Payments of principal and interest on these bonds are insured under a municipal bond insurance policy. A portion of these bonds were defeased by the 2007 bond series, and are no longer outstanding at December 31, 2007.

Hospital Revenue Bonds (Series 1993):

The Series 1993 tax-exempt bonds were issued by the Memorial Hospital Service District of the Parish of Calcasieu, Louisiana on behalf of the System. The payments to the bondholders are funded and guaranteed by the System under loan agreements with the trustees of the respective bond issues.

The net proceeds from the Series 1993 bonds were used to advance refund previous bond issues and to provide funds for new capital improvements.

Hospital Revenue Bonds (Series 2000):

The Series 2000 tax-exempt bonds were issued by the Louisiana Public Facilities Authority. The payments to the bondholders were funded and guaranteed by the System under loan agreements with the trustees of the respective bond issues.

The net proceeds from the Series 2000 bonds were used to provide funds for new capital improvements. A portion of these funds was used by the System to acquire equipment for the Hospital, to construct the new healthcare facility (the Women's facility), and to acquire equipment for the new facility. These bonds were defeased in total with the 2007 bond series and are no longer included in the consolidated balance sheet. The unpaid principal balance as of December 31, 2007 was approximately \$41,800,000.

**SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

6. Long-term debt (continued)

Hospital Revenue Bonds (Series 2007):

During November of 2007, the Hospital completed an offering of \$69,775,000 of hospital revenue and refunding bonds. The Series 2007 bonds are fixed rate serial bonds with rates ranging from 6.25% to 6.375% and are scheduled to mature at various times through December 1, 2034.

The proceeds of the Series 2007 Bonds were used, along with other available funds, to advance refund previous bond issues and to provide funds for new capital improvements.

7. Insurance programs

Any exposure under \$100,000 per claim for professional liability is covered by the System. Additional professional liability coverage is provided by the Louisiana Patient's Compensation Fund up to the present statutory maximum of \$500,000 per claim (exclusive of additional amounts for future medical expense provided by law). The preceding policies are on an occurrence basis.

The System is self insured for group health insurance and pays all claims up to \$200,000 per person. A stop loss policy pays claims in excess of this amount. The System is also self insured for workers' compensation liability up to the deductible of its excess workers' compensation policy of \$250,000 per claim.

The System has reflected its estimate of the ultimate liability for known and incurred, but not reported, claims in the accompanying financial statements.

8. Retirement plans

The Hospital has a defined contribution plan that covers substantially all full-time employees who are over the age of twenty-one and who have met eligibility requirements. Contributions by the Hospital are discretionary and totalled approximately \$1,154,000 and \$1,105,600 for the years ended December 31, 2007, and 2006, respectively.

The Hospital also maintains a pretax retirement plan under code Section 403(b) in which substantially all of the employees of the Hospital can participate. The Hospital does not make any contributions to this plan.

**SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

9. Business and credit concentrations

Financial instruments which potentially subject the System to concentrations of credit risk consist principally of unsecured accounts receivable and temporary cash investments.

The System maintains its cash investments with several financial institutions operating primarily in southern Louisiana. The balances, at times, may exceed federally insured limits. Management believes the credit risk associated with these deposits is minimal.

The System grants credit to patients, substantially all of whom are regional residents. The System generally does not require collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, and commercial insurance policies).

The mix of receivables from patients and third-party payors at December 31, 2007 and 2006, was as follows:

	<u>2007</u>	<u>2006</u>
Medicare	30.07%	27.6%
Medicaid	15.45%	17.6%
Commercial insurance and managed care organizations	34.81%	36.2%
Self-pay patients and other	<u>19.67%</u>	<u>18.6%</u>
	<u>100.0%</u>	<u>100.0%</u>

10. Leases

The Hospital leases various pieces of equipment and operating facilities under operating leases which expire at various dates through the year ending December 31, 2011. Total rental expenses under these leases totalled approximately \$1,123,000 and \$1,436,000 during the years ended December 31, 2007 and 2006, respectively.

The following is a schedule by year of future minimum lease payments required under all of these operating leases which have initial or remaining non-cancelable lease terms in excess of one year:

<u>Year ending December 31<sup>st</sup></u>	<u>Amount</u>
2008	\$ 690,144
2009	221,742
2010	78,903
2011	<u>19,726</u>
	<u>\$ 1,010,515</u>

# **SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.**

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

### **11. Classification of expenses**

The following table approximates the classification of expenses incurred during the years ended December 31, 2007 and 2006 (in thousands):

	<u>2007</u>	<u>2006</u>
Patient related services	\$ 160,928	\$ 152,581
General and administrative expenses	42,639	41,890
Total operating expenses	<u>\$ 203,567</u>	<u>\$ 194,471</u>

### **12. Disclosures about the fair value of financial instruments**

*Cash and cash equivalents, net patient accounts receivable, other receivables, other assets, accounts payable, accrued interest payable, other accrued expenses, and estimated third-party payor settlements* - the carrying amounts approximate fair values because of the short maturity of these instruments.

*Assets limited as to use and short-term investments* - the carrying amounts reported on the balance sheets are fair values based on quoted market prices.

*Long-term debt* - the fair value of the Hospital's long-term debt is estimated based on current rates. This estimate does not consider the estimated costs of refinancing.

The Hospital's financial instruments whose estimated fair value differs from its carrying amount are summarized as follows at December 31<sup>st</sup>:

	<u>2007</u>		<u>2006</u>	
	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>
Long-term debt (in thousands)	<u>\$ 108,082</u>	<u>\$ 109,233</u>	<u>\$ 100,104</u>	<u>\$ 105,110</u>

*Limitations* - fair value estimates are made at a specific point in time, based on relevant market information about the financial instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

**SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

13. Related party transactions

Certain members of the Board of Trustees are affiliated with organizations that provide services to the System and its affiliates. The System has a policy of periodically obtaining independent reviews of its insurance program, periodically rotating its banking relationships, and obtaining formal bids on all significant construction projects.

14. Commitments and contingencies

The System is involved in various legal actions and claims that arose as a result of events that occurred in the normal course of operations. The ultimate resolution of these matters is not ascertainable at this time; however, management is of the opinion that any liability or loss in excess of insurance coverage resulting from such litigation will not have a material effect upon the financial position of the System. However, a provision has been made in the financial statements related to these claims.

15. Community service (unaudited)

In addition to providing indigent and uncompensated care, the System operates an emergency room, open to the public 24 hours a day, 7 days a week; provides various community screenings for the detection of diseases and disorders; provides a forum for various health and wellness activities; supports various community healthcare initiatives; provides various community health education classes, speeches, and articles published through various media; and provides indirect support for rural healthcare. The amount of charges forgone for services and supplies furnished under the System's charity care policy totalled approximately \$20,796,000 and \$16,144,000 for the years ended December 31, 2007 and 2006, respectively.

16. Subsequent events

The Hospital has signed a contract with a major software vendor to essentially change the Hospital's business and clinical information systems. The detail terms of this agreement are proprietary; however, they will result in a significant upgrade to these information systems over three to five years at an estimated cost of six million dollars for related hardware, software, installation and training.





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**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON  
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL  
STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING  
STANDARDS**

The Board of Trustees  
Southwest Louisiana Health Care System, Inc.

We have audited the financial statements of the Southwest Louisiana Health Care System, Inc. (the System) as of and for the year ended December 31, 2007, and have issued our report thereon dated April 17, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the System's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control efficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be a material weakness, as defined above.

### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the financial statements of the System are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the System, in a separate letter dated April 24, 2008.

This report is intended solely for the information and use of the Board of Commissioners, federal and state awarding agencies, and the Louisiana Legislative Auditor and is not intended to be and should not be used by anyone other than these specified parties. However, under Louisiana Revised Statute 24:513, this report is distributed by the Legislative Auditor as a public document.

*Postlethwaite; Netterville*  
Baton Rouge, Louisiana  
June 26, 2008



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April 24, 2008

To Management and the Board of Directors  
Lake Charles Memorial Hospital  
Baton Rouge, LA

We have audited the financial statements of the Lake Charles Memorial Hospital, for the year ended December 31, 2007 and have issued our report thereon. As part of our examination, we made a study and evaluation of internal accounting control to the extent we considered necessary to evaluate the system as required by auditing standards generally accepted in the United States of America. Under these standards, the purposes of such evaluation are to establish a basis for reliance on the system of internal accounting control in determining the nature, timing, and extent of other auditing procedures that are necessary for expressing an opinion on the financial statements and to assist the auditor in planning and performing his audit of the financial statements.

The objective of internal control is to provide reasonable, but not absolute, assurance as to the safeguarding of assets against loss from unauthorized use or disposition, and the reliability of the financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a system of internal accounting control should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

No matter how good a system, there are inherent limitations that should be recognized in considering the potential effectiveness of internal accounting. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personal factors. Control procedures whose effectiveness depends upon segregation of duties can be circumvented by collusion. Similarly, control procedures can be circumvented intentionally by management either with respect to the execution and recording of transactions or with respect to the estimates and judgments required in the preparation of financial statements. Further, projection of any evaluation of internal accounting control to future periods is subject to the risk that the degree of compliance with the procedures may deteriorate. We say this simply to suggest that any system needs to be constantly reviewed and improved where necessary.

During the course of our audit, we made several observations which we feel should be brought to your attention. Concerning these matters, we offer the following comments and recommendations:

#### Federal Funds

During our audit we noted that there is not a grant department or an accountant that monitors all of the federal funds that are received by all departments of the Hospital. Additionally, we have not observed any internal monitoring of the expenditure in accordance with the grants or awards by personnel that are independent of administering the grants. We recommend that the hospital either create a grant department or designate an accountant to monitor these funds throughout the year. We suggest that in order to ensure understanding of and compliance with specific grant terms as well as consistency of reporting for all such grant agreements, that appropriate personnel review grant agreements on a timely basis and establish documented and consistent procedures pertaining to the appropriate accounting for all grants. We believe that this process will make accounting for and classifying of grants an easier and more routine task.

#### Management's Response:

Management agrees with the recommendation, however, believes that its current processes have not resulting in errors in accounting or compliance with grant requirements. Management is currently evaluating new procedures within the accounting department to track grant accounting. Additionally, the Hospital's new internal auditor will evaluate appropriate monitoring procedures to be performed on the grants.

#### Telemedicine

During our audit we noted the Telemedicine funds are accounted for and processed outside of the accounting department. We also noted that there is a cash account in the name of the Hospital; however, it is not on the Hospital's general ledger system. We recommend that you record the cash on the general ledger and a corresponding liability for funds owed to the other members of the Telemedicine Consortium. We suggest that someone outside of the Telemedicine department reconcile this account on a regular basis. We also suggest that someone in accounting become familiar with the processes and procedures of the Telemedicine program, to provide support and accounting guidance when necessary. As mentioned above, periodic monitoring of compliance with the grant terms should also be performed.

Management's Response:

Management agrees with the recommendation, however, believes that the processes and procedures that have been utilized in the past by the Telemedicine department have provided adequate controls over the Telemedicine funds. Management is currently evaluating new procedures within the accounting department to track Telemedicine funds and reconcile bank accounts. Additionally, all activity will be recorded in the Hospital's general ledger system.

Allowance for Doubtful Accounts and Contractual Adjustments

The allowance for doubtful accounts and contractual adjustments model is reviewed at a high level by management. We recommend that someone independent of the calculation, periodically review this estimate at a more detailed level. The review should include testing the adequacy of the self pay percentages and the model as a whole on a quarterly basis. This review will allow for changes in the estimate of the allowance and contractual adjustments on a timelier basis.

Management's Response:

Management agrees with the recommendation and is discussing the review with personnel in the Revenue Management Department.

Elimination of Inter-company Transactions

During our audit we noted that inter-company management fees and rent expense was not eliminated during consolidation. On consolidated financial statements, generally accepted accounting principles require inter-company transactions to be eliminated. We recommend that you eliminate these transactions to properly reflect the transactions on the consolidated financial statements.

Management's Response:

The financial statements will contain the eliminations in future financial statements.

Input of Salary Information

Salary information is input into the system by the HR department. During our audit procedures we noted that there is not an independent employee that periodically checks the accuracy of the data being entered. We recommend someone review this information periodically for accuracy. This review will help ensure the amount being paid to employees is accurate, and the amount reported on the financials is also accurate.

Management's Response:

Management agrees that the initial input of salary information should be reviewed by an independent person. Management is currently evaluating new policies and procedures in the accounting department to address this review of information.

We want to thank management for the courtesies extended to us during the audit. If you have any questions or need any assistance in the implementation of these recommendations, we would be pleased to offer our services.

This report is intended solely for the information and use of the board of directors, management, federal awarding agencies and is not intended to be, and should not be, used by anyone other than these specified parties.

*Postlethwaite & Netterville*

Baton Rouge, Louisiana  
April 24, 2008